James K. Glassman Post 4/4/93

Raising the Minimum Wage Isn't the Answer

The biggest economic problem right now is not growth, inflation or unemployment. It's that so many Americans can't earn a decent living even though they work long hours at tough jobs.

"As a group," says Labor Secretary Robert Reich, "these Americans go by a name that ought to be an oxymoron: the working poor."

Over the past 15 years, the real earnings of lower-income families have dropped while those of upper-income families have risen. That's an abrupt change from the 1950s, '60 and '70s, when real incomes doubled across all income groups.

The divergence is growing, and it has serious moral, political and social implications. For example, it nearly defeated important trade legislation last year since many Americans believe, incorrectly, that foreigners are to blame for their low pay.

What can Reich and his colleagues do to help the working poor? Alas, not much. Like many economic problems, this one is not really amenable to a government solution.

To understand why, just look at one step that President Clinton has proposed—raising the minimum wage from $4.25 to $5.15 an hour. He believes this increase is long overdue: If the minimum wage set in 1979 had been adjusted for inflation, it would be about $6 today.

Last year, only 3 percent of full-time American workers earned $4.25 or less. But a hike in the minimum wage could affect a far higher proportion—certainly everyone making up to $5.14 an hour and probably those making $6 or $6.50 as well. The Economic Policy Institute estimates that 20 percent of the work force would feel the change.

But the government can't simply require businesses to pay workers more without causing some adverse consequences. Otherwise, as a paper issued by Republicans on the Joint Economic Committee puts it, "there would be no logical reason why the minimum wage could not be set at $10 or $400 per hour."

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One result is that some workers would lose their jobs. In a famous 1978 survey in the American Economic Review, 90 percent of economists agreed that raising the minimum wage increases unemployment among low-skilled workers.

That stands to reason. The Clinton legislation, for example, would cost a business with 100 minimum-wage workers about $200,000 a year. That extra cost could come out of profits (thus, no expansion next year), or it could be defrayed by firing 20 low-paid workers and replacing them with machines or with a few more skilled workers, whose wages don't have to rise by government decree.

But this link between minimum wages and lost jobs was recently challenged by research conducted by economists David Card and Alan Krueger of Princeton. (Krueger was later hired by Reich as chief economist for the Labor Department.)

In April 1992, New Jersey raised the minimum wage within its borders from $4.25 to $5.05, so Card and Krueger looked at how employment at fast-food restaurants in that state changed—before and after the increase. They compared those changes with fast-food employment in nearby Pennsylvania, which kept the the $4.25 standard.

The results surprised most economists—including Card and Krueger themselves. They found "no evidence that the rise in New Jersey's minimum wage reduced employment." In fact, employment went up! New Jersey outdid Pennsylvania by 12 percentage points.

Had Card and Krueger found an economic perpetual-motion machine? Some administration officials seemed to think so. Said Laura D'Andrea Tyson, chairman of the Council of Economic Advisers, "The theory that somehow an increase in the minimum wage might affect employment is now at odds with the empirical evidence."

But is the evidence valid? Economists David Neumark of Michigan State and William Wascher of the Federal Reserve Board have doubts.

While Card and Krueger studied the results of a telephone survey of employers, Neumark and Wascher, in a reevaluation published last week, examined actual payroll records from Burger King and Wendy's franchises. These records gave the opposite conclusion: Jobs in New Jersey decreased 5 percent compared with Pennsylvania.

The Labor Department disputes the findings, pointing out that Neumark and Washcer received their data courtesy of the Employment Policies Institute, an interest group funded in large part by restaurants, and that they looked at a far smaller sample than Card and Krueger.

These differences will be hashed out tomorrow at a hearing of the Joint Economic Committee, whose senior economist, Reed Garfield, says, "Compassionate politicians and well-meaning government programs like the minimum wage cannot repeal the laws of supply and demand any more than they can repeal the law of gravity."

In fact, the real reason that so many workers are paid so little is that the work they do isn't valuable enough.

"Skills matter more" is the way Reich describes the workplace today, and he has the numbers to prove it. A worker with a high school education and no training earns an average of $365 a week while a trained worker with the same education earns $513 and a trained worker who has graduated from college earns $785.

The real question is how to improve the skills of the lower half of the work force so employers will pay them more. It's doubtful, based on history, that the answer will come from government.

Instead, it will come from businesses—which will have a better chance to fund training if they're relieved of some of the high costs government imposes, including the minimum wage.

But the ultimate answer lies with workers themselves. In a high-tech world, what they earn is directly tied to what they know. Government can help a bit through tax breaks for education, but ultimately the cure for low working wages may be nothing more mysterious than high personal diligence.